Nos. 73-437, 73-457, 73-464

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IN THE

# Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-437

MOBIL OIL CORPORATION, *Petitioner*

v.

FEDERAL POWER COMMISSION

No. 73-457

PUBLIC SERVICE COMMISSION OF THE STATE OF NEW YORK, *Petitioner*

v.

FEDERAL POWER COMMISSION

No. 73-464

MUNICIPAL DISTRIBUTORS GROUP, *Petitioner*

v.

FEDERAL POWER COMMISSION

On Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit

## BRIEF OF RESPONDENTS EXXON CORPORATION, *ET AL.*

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**On Writs of Certiorari to the United States Court of Appeals for the Fifth Circuit**

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## BRIEF OF RESPONDENTS EXXON CORPORATION, *ET AL.*

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## QUESTION PRESENTED

These proceedings commenced in 1961 with the institution by the Federal Power Commission of the *Southern*

*Louisiana Area Rate Case* to establish just and reasonable rates for producer gas sales in the Southern Louisiana Area.

In 1968 the Commission issued its first decision. On appeal, the court below specifically fashioned its judgment to authorize the Commission to reopen the case, to consider the effect of the rates fixed by the Commission upon the critical gas shortage and to establish modified rates, both past and prospective, if the Commission found this to be in accord with the evidence and in the public interest. Petitions for writs of certiorari to review this decision of the Fifth Circuit were denied (400 U.S. 950). Thereafter, the Commission reopened the proceedings, consolidated them with a new proceeding commenced in 1969, and, in July 1971 issued its decision. On appeal, the court below held that the Commission's decision was clearly within its authority under the Natural Gas Act as construed by this Court in *Permian*[1] and held that the decision was supported by substantial evidence.

The questions presented are:

1. Whether the court below correctly held that the Commission's decision is supported by substantial evidence?

2. Where the Commission acted under the Court's order to reopen the case, take new evidence, and based on that evidence, rescinded its prior decision and substituted a new rate structure, did the Commission exceed its powers under the Natural Gas Act?

3. Whether the Commission's rate structure, which permits refunds to be worked off by the commitment of additional new gas supplies to the interstate market, and

1. *Permian Basin Area Rate Cases*, 390 U.S. 747 (1968).

which makes a portion of the Commission's ceiling rates dependent on the commitment of new gas supplies to the interstate market, is unduly discriminatory?

## STATEMENT OF THE CASE

These proceedings commenced on May 10, 1961 (25 F.P.C. 942), with the institution by the Federal Power Commission of the *Southern Louisiana Area Rate Case* to establish just and reasonable rates for producer gas sales in the Southern Louisiana Area—an area which presently supplies one-third of the nation's interstate gas and has a large potential for significant additions to that gas supply. Hearings and submission extended over more than seven years. Thirty-four thousand pages of testimony were recorded and 272 exhibits received. On September 25, 1968, the Commission issued its first decision (Opinion 546; 40 F.P.C. 530) and, on March 20, 1969, a modified decision on rehearing (Opinion 546-A; 41 F.P.C. 301). The decision was appealed to the Fifth Circuit.

Four months before the Commission's decision, this Court issued its opinion in *Permian*, the first area rate case to reach this Court. *Southern Louisiana* is the second. In *Permian*, the Court noted, prophetically:

(1) the *Permian* proceeding was "to be merely the first of many steps toward a more expeditious and effective system of regulation." (390 U.S. at 772, n. 37)

(2) "that the Commission will continue to examine both the premises of its regulatory methods and the consequences for the industry's future of its rate-making orders." (390 U.S. at 816, n. 99)

In the meantime, a gas shortage had been developing throughout the nation and was becoming more apparent. Shortly before oral argument in the Court of Appeals the Commission released a Staff Report concluding that a demand exceeding supply was imminent.[2] Numerous public statements of the members of the Commission and other public bodies throughout the ensuing months confirmed this conclusion and emphasized that the situation was becoming critical.

On March 19, 1970, the Court of Appeals issued its judgment in the form of an "affirmance" of the Commission's decision, but with "serious misgivings."[3] Taking cognizance of the Staff Report and of the public statements by the members of the Commission, the court noted that "A serious shortage, in fact, may already be unavoidable."[4] The court pointed out that the Commission had made no attempt to determine whether the rates fixed in its decision were adequate to call forth sufficient gas supplies. It emphasized the seriousness of this deficiency, particularly in light of the fact that "the Commission failed to approach supply and demand in either a semi-quantitative or qualitative way,"[5] notwith-

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2. Federal Power Commission Staff Report on National Gas Supply and Demand, October 1, 1969. *See also* subsequent Report noted by this Court in *F.P.C. v. Louisiana Power & Light Co.*, 406 U.S. 621, 626 (1972).

3. *Southern Louisiana Area Rate Cases (Austral Oil Co. v. F.P.C.)* 428 F.2d 407, 439; on rehearing 444 F.2d 125 (5th Cir. 1970); *cert. denied sub nom., Municipal Distributors Group v. F.P.C.*, 400 U.S. 950 (1970). This decision is sometimes referred to in the record and opinions herein as *"Austral"* or *"SoLa I."* The instant decision is sometimes referred to as *"Placid"* or *"SoLa II."*

4. 428 F.2d at 437.

5. 428 F.2d at 436.

standing evidence that the nation was faced with "a severe gas shortage, with disastrous effects on consumers and the economy alike."[6] Because of these deficiencies in the Commission decision, the court accompanied its "affirmance" with directions on rehearing making it clear that under its "judgment" the Commission's power was left intact to make such changes in its order, as to both past and future rates, as it found to be in the public interest, stating:

> "We wish to make crystal clear the authority of the Commission in this case to reopen *any* part of its order that circumstances require be reopened. Under section 19(b) of the Natural Gas Act, this Court has the broad remedial powers that inhere in a court of equity, and pursuant to our equitable powers we make it part of the remedy in this case that the authority of the Commission to reopen any part of its orders, including those affecting revenues from gas already delivered, is left intact. The Commission can make retrospective as well as prospective adjustments in this case if it finds that it is in the public interest to do so.
>
> ". . . it is our judgment that the Commission shall have the power and the duty to remedy the situation by changing its orders."[7] (emphasis by the court)

Petitions for certiorari to review this decision of the Fifth Circuit were denied by this Court.[8]

Meanwhile, in March 1969, the Commission had instituted proceedings to reconsider rates for the offshore

6. 428 F.2d at 435, n. 87.

7. 444 F.2d at 126-27.

8. Nos. 669, 680-685, 691 and 692, October Term, 1969, 400 U.S. 950.

portion of the Southern Louisiana Area.[9] Later in the year this proceeding had been expanded to include the entire area.[10] After the decision of the Court of Appeals, and in line with the authority granted it by that court, the Commission reopened the 1961 proceeding and consolidated it with the new proceeding.[11] In these combined proceedings settlement conferences instituted by the Presiding Examiner were joined in by all interested parties—producers, pipelines, distributors, state commissions, municipally owned utilities and the Commission Staff—in an effort to reach agreement on a proposal to submit to the Commission. A settlement proposal was finally formulated which had the full support of the Commission Staff as in the public interest (I A. 130-32) and was agreed to by a large majority of all interests.[12] The Commission incorporated the settlement proposal in the record and invited evidence concerning it. Upon review of the whole record the Commission found the terms of the settlement proposal to be in the public interest and supported by substantial evidence (Opinion 598).

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9. 41 F.P.C. 378; I A. 2. Record references herein, unless otherwise noted, are identical to those in the Brief for Petitioner Mobil Oil Corporation; see n. 1, p. 1 thereof.

10. 42 F.P.C. 1110; I A. 73.

11. 44 F.P.C. 1638; I A. 352.

12. The Commission pointed out (II A. 589):

> "15. In support of the settlement proposal are 32 major distribution companies representing 25 percent of the gas distribution operations in the United States, serving about 10.3 million customers at retail; 55 gas distribution companies which supply gas service to more than 10 million customers; *all* interstate pipelines purchasing gas from the Southern Louisiana area; and 46 natural gas producers, comprising 80 percent of the total gas production flowing from the area." (emphasis by the Commission)

It said:

> "We have more than a settlement proposal before us. We have the entire record made in the original Southern Louisiana proceedings, plus the record opened with the institution of Docket No. AR69-1 and concluded after Docket No. AR61-2 was consolidated with it. The settlement proposal was obviously heavily influenced by the teachings of *Austral* [the decision of the Fifth Circuit on the first appeal], as the parties perceived those teachings, and so was the record made in conjunction with it. It is our duty to review that record and to make findings thereon, and to come to conclusions therefrom. Only if substantial evidence supports it can we approve the settlement proposal, and this means that we must analyze supply and demand, supply-cost relationships, and costing methodology. Rate design, incentives, refunds, and economic considerations, as the record permits insight into these matters must also be discussed." (II A. 594, n. omitted)

Accordingly, the Commission appraised the proposal in the light of the massive record it had compiled in the proceedings since 1961, including the additional year of hearings directed largely to the terms of the settlement proposal. The record compiled in the reopened proceeding contains over 7,800 pages of testimony, with 111 new exhibits.[13] This evidence included testimony concerning the gas shortage and estimates of the new supply needed to alleviate the problem (II A. 601-24); economic and cost evidence in support of rate levels needed to induce additional supply (II A. 617-48); the amount

13. Many of these exhibits are comprehensive studies of the factual issues extending over hundreds of pages (*e.g.*, Stanford Research Institute (Ex. 4) reviewed by the Commission at II A. 615).

of capital required to develop additional supply (II A. 623-30) and the need for a higher price to stimulate production of additional supply (II A. 617-24).

After a careful consideration and review of all the evidence, the Commission found the proposed settlement to be just and reasonable, supported by substantial evidence and within the zone of reasonableness. The ceiling rates in Opinion 546 (issued in 1968), which had never gone into effect, were found to "perform no office" (II A. 587).

The Commission established rates of 22.375 cents per Mcf for gas produced onshore and of 21.375 cents for gas produced offshore for all contracts dated prior to October 1, 1968 ("flowing gas") with an automatic increase of 0.5 cents on October 1, 1973 (II A. 657). As an incentive for increasing the gas supply, the Commission also established increases in the rates for flowing gas of up to 1.5 cents per Mcf, contingent upon the industry finding and dedicating new gas reserves (II A. 649, 658).[14] For contracts dated on or after October 1, 1968 ("new gas"), the rate was established at 26 cents for both onshore and offshore gas, with an automatic increase of 1.0 cent on October 1, 1974 (II A. 657).

The Commission imposed a moratorium upon the filing of producer rate increases for flowing and new gas, respectively, until October 1, 1976 and October 1, 1977

14. The formula works thus: If, before October 1, 1977, the industry as a whole finds and dedicates to the interstate market new gas reserves in the Southern Louisiana Area of 7½ trillion cubic feet, the rate for flowing gas will escalate by ½¢; if, prior to that time, such reserves equal 11¼ trillion cubic feet, the rate will increase by an additional ½¢; if, prior to the same time, such reserves equal 15 trillion cubic feet, a final ½¢ escalation will become effective.

(II A. 651-52), established minimum pipeline rates for the transportation of certain liquid and liquefiable hydrocarbons (II A. 688), and eliminated the price differential between new casinghead gas and new gas-well gas (II A. 651).

The Commission dealt with refunds in the following manner. The rates established by the Commission in its final order were higher than those which would have been established had its 1968 decision gone into effect.[15] Had the flowing gas rates approved by the court as just and reasonable been the sole basis for determining refunds, such refunds would have been substantially less than the $150,000,000 prescribed by the Commission (App. C, p. 43). However, under the proposed settlement, a "refund obligation" was provided for past deliveries in the amount of $150,000,000, with a proviso that this refund obligation could be worked off by the commitment of additional gas reserves to the interstate market (II A. 653). The Commission adopted this provision of the settlement proposal[16] as an integral part

15. The rates which would have been established had the 1968 order become effective ranged from 17¢ per Mcf to 20.0¢ per Mcf (App. C, p. 8). "App. C" herein refers to Appendix C to Mobil's Petition for a Writ of Certiorari in No. 73-437.

16. The Commission's formula works thus (II A. 666): Any company with a "refund obligation" to any natural gas pipeline company is allowed to reduce the refund obligation by 1¢ for each Mcf of new gas reserves committed in the Southern Louisiana Area to the interstate market for a period ending on October 1, 1977. Any portion of the "refund obligation" not so discharged is payable in cash with interest. The producer is required to commit at least 50% of the new reserves to the purchaser to whom the refund would otherwise be payable (II A. 666).

The reserves committed to reduce the refund obligation may not be counted by the producer committing those reserves as a part of the industry reserves required to trigger the escalated prices for flowing gas referred to in footnote 14 above (II A. 658).

of its rate structure for the 1961-71 period utilizing as refund floors rates below those found by the Commission in its final order to be just and reasonable (II A. 652-53).[17]

The court of appeals sustained the Commission in full (App. C, p. 58). It carefully reviewed and analyzed the evidence. It held that the Commission had diligently complied with this Court's decision in *Permian* and with the teachings of the Fifth Circuit's earlier decision in this case. It found the Commission's order to be just and reasonable, in the public interest and supported by substantial evidence.

Specifically, the court of appeals reviewed the history of producer rate regulation and traced the long proceedings covering this particular area (App. C, pp. 6-15). It rejected categorically the "notion" that its earlier "affirmance" of the Commission's 1968 decision in any way impaired the Commission's power to alter or modify any of the provisions of such decision (App. C, p. 41). It examined the propriety of taking into consideration the settlement proposal, found this to be proper, and found that

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17. Cost studies in the record support all of these refund floor rates (IV A. 585, IV A. 601, V A. 176e, V A. 199e-200e, II A. 643-48, II A. 653-54).

The refund floors approved by the Commission were 20.625¢ per Mcf (onshore) and 19.625¢ per Mcf (offshore) for the pre-1965 period, and 21.25¢ (onshore) and 20.25¢ (offshore) for the period January 1, 1965 to September 30, 1968. These price levels were consistent with various company-wide settlements during these periods and the Commission's Statement of General Policy No. 61-1 (II A. 652-53, n. 138, n. 139). For the period October 1, 1968 to January 1, 1971, the level was computed at 30.5% of the difference between the rates in effect prior to October 1, 1970 and the rates fixed by the Commission in Opinion 546. While this fraction was selected to make up the balance of the negotiated $150 million refund figure, the Commission found that it provided an amount approximately equivalent to the other refund calculations and was just and reasonable (II A. 654).

the Commission's final order was based on substantial independent evidence (App. C, pp. 20-23, 58). It reviewed the shortage of natural gas and the potential and future importance of the Southern Louisiana Area as a source of new supply (App. C, pp. 23-29), treated the rate structure, which included incentives for new production, as an interrelated package (App. C, pp. 30-51), and concluded that the establishment of such rates was within the discretion of the Commission and was amply supported by the record. In addition, the court pointed out that the rates clearly fell "within the range of cost estimates which the evidence discloses," quite apart from the noncost factors considered by the Commission (App. C, pp. 31, 39).[18] The court concluded that this rate structure was amply supported by "substantial evidence on the record as a whole" (App. C, p. 30).

## SUMMARY OF ARGUMENT

This Court is asked to review the decision by the Commission dealing with the second area designated for producer rate regulation; *Permian* was the first. After nearly 13 years of proceedings, questions are raised concerning the sufficiency of the evidence relied on by the Commission in prescribing just and reasonable rates and concerning whether the principles of area-wide group regulation applied by the Commission resulted in undue discrimination. The answer is that the Commission has acted within

18. Four different cost studies were presented (II A. 644). These studies estimated costs of production ranging from 18.2¢ (V A. 239e) to 24.03¢ (V A. 202e) per Mcf for gas flowing under contracts dated prior to October 1, 1968. With respect to gas sold under contracts dated on or after October 1, 1968, the cost estimates based on a 1969 test year ranged from 19.39¢ to 38.02¢ (II A. 633). The rates ultimately fixed by the Commission, even including all incentive increments, were well within the range of cost estimates.

its discretion as defined by this Court in *Permian*, and its decision is supported by substantial evidence.[18a]

1. In reaching its decision the Commission, as a first step, had to reevaluate and reconsider the propriety of its earlier Opinion 546 issued in 1968. Upon review of that opinion the Court of Appeals in *Austral* included as a specific part of its judgment that the Commission could reexamine its earlier decision and modify it, both as to rates for gas delivered in the past and as to whether refunds should be required. This Court denied petitions for writs of certiorari.

   Under the broad equitable powers of the Court of Appeals to fashion appropriate remedies and in light of the fact that no rates under the earlier Opinion 546 ever became effective, the Commission's present decision prescribing different rates and refunds is not unlawful and does not constitute "retroactive ratemaking."

2. The prescription of a new rate structure in substitution (as to the pre-1971 period) for that contained in Opinion 546 was fully justified by the evidence, particularly with respect to three key issues.

   a. Unlike its earlier decision, the Commission has now determined that the price for flowing

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18a. These respondents supported a distributor group motion seeking approval of a proposed settlement of the proceedings, supported the Commission's resulting opinion in the Court of Appeals and support in this Court the affirmance of the decision of the court below.

gas has an important impact on gas supplies and that gas supply trends must be given important weight.

b. The Commission now recognizes the imprecision and unreliability of the various estimates of the cost of natural gas.

c. Mounting evidence properly convinced the Commission that its earlier assumptions concerning the stability of the estimates of natural gas costs were unfounded.

3. Virtually every estimate of the cost of flowing gas exceeded the average revenues being received by producers as a group so that no refunds at all need have been required. Nevertheless, the Commission did not exceed its discretion in treating the question of refunds as a part of a complex rate design package. Allowing refunds to be discharged by the commitment of new reserves to the jurisdictional market serves the valid dual function of attracting new gas supplies to the market and of avoiding diversion of producer funds otherwise available for gas exploration.

4. The provision for escalations in the ceiling rate for flowing gas, contingent on the commitment to the jurisdictional market of specified volumes of new reserves, was a valid exercise of the Commission's power to design a rate structure which will meet a variety of lawful objectives. This provision provides opportunity for increased ceilings to help in generating needed capital funds and in meeting rising costs, but assures that such increases will not be levied

upon consumers unless accompanied by increased new supplies of gas. In seeking such valid, multiple objectives the Commission did not err in departing from "public utility" concepts because such concepts have no application to regulation of field sales of natural gas.

5. There is no undue discrimination among producers resulting from the refund work-off and flowing gas contingent escalation provisions, other than those differences inherent in group regulation of individual contracts made over lengthy time periods for the sale of a wasting commodity. Where such differences in impact of the rate structure are due solely to earlier voluntary actions, a single producer (Mobil) cannot assert a valid claim of undue discrimination —particularly where all others similarly situated do not assert such a claim.

   Allegations that consumers are discriminated against by these provisions are wholly theoretical and are undercut by the concurrence in such provisions by many other consumers. Claims that these provisions discriminate against new entrants into gas production in Southern Louisiana were not substantiated by any evidence and were properly rejected by the court below as being unpersuasive.

6. None of a variety of subsidiary arguments made by petitioners are sustainable.

   a. The evidence in this proceeding supported the Commission's provision for pipeline charges for liquid and liquefiable hydrocarbon trans-

portation, regardless of the outcome of a different nonevidentiary proceeding.

b. The Commission did not err in giving significant weight to a settlement proposal which attracted broad support from among the different interests represented, particularly where it based its evaluation of the proposal on the substantial evidence before it.

c. The Commission's decision to eliminate the ceiling rate distinction between new casinghead gas and new gas-well gas was not error where supported by substantial evidence and where such rate design choices are within the Commission's proper discretion.

d. The prospective ceiling rate for new gas as a part of the total rate structure is just and reasonable.

## ARGUMENT

The decision below correctly holds that the Commission's order is supported by substantial evidence, is in the public interest, and was entered pursuant to the Commission's statutory powers as interpreted in *Permian* and other controlling decisions of this Court.

The contentions of the three petitioners in these consolidated cases relate to evidentiary quarrels which do not affect the substance of the Commission's order. Indeed, it is totally unrealistic to contend in today's market that a rate structure including incentive escalations up to one and one-half cents per Mcf over rates for flowing gas of 21.375 cents and 22.375 cents per Mcf, and for new gas of 26 cents

per Mcf is not just and reasonable.[19] Later Commission decisions such as *Permian II* suggest that if this cause was remanded for further proceedings,[20] the Commission would be compelled by the evidence to enter an order fixing rates even higher than those fixed herein.[21] But in a rational administrative and judicial process finality must come at some time. These proceedings have consumed nearly 13 years. They have received painstaking consideration by the Commission and an informed and conscientious review by the court of appeals. The challenged incentive provisions in the Commission's order have received, in principle, the approval of this Court.[22] They clearly serve the public interest at this time of gas

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19. The court below pointed out that at the time of its opinion the Commission already had certificated 62 separate sales to the interstate market at rates ranging from 26¢ to 40¢ per Mcf under Order 431 covering emergency purchases (App. C, p. 61, n. 39). In testimony given on January 24, 1974 before the Energy Subcommittee of the Senate Finance Committee, Federal Energy Administrator, William E. Simon, testified that recent sales of natural gas in intrastate commerce have been made at prices up to $1.25 per Mcf.

20. The rate structure is an integral whole; its separate components cannot be meaningfully evaluated in isolation because of their interdependence (II A. 588, 870).

21. In *Permian II*, Op. 662, issued August 7, 1973, the Commission prescribed rates of 23¢ for flowing gas and 35¢ per Mcf for new gas—both substantially above the rates here under review.

22. In *Permian* this Court held (390 U.S. at 797):

"We have emphasized that courts are without authority to set aside any rate adopted by the Commission which is within a 'zone of reasonableness.' . . . The Commission may, within this zone, employ price functionally in order to achieve relevant regulatory purposes; it may, in particular, take fully into account the probable consequences of a given price level for future programs of exploration and production."

supply crisis.[23] The vital interests of the nation require an end to the proceedings affecting this important producing region. Nothing in the contentions advanced by petitioners herein warrants the setting aside of the Commission's decision.

The order of the Commission reflects consideration of a settlement proposal supported by the enormous record in this case. Settlement conferences were convened by the Presiding Examiner with a direction that the parties confer for the purpose of attempting to formulate a suitable settlement (II A. 671). The Commission Staff participated throughout and fully supported the final result (II A. 589).

While an agreement with respect to rates may not override the public interest or be binding upon dissenters, a proposed settlement with such broad support as the present one, arrived at under the auspices of the Commission and supported by its Staff, is certainly worthy of consideration and, to say the least, we submit, furnishes a substantial basis for a presumption that the rates proposed are not unjust and unreasonable.

Petitioners argue that this Court should preclude the Commission from correcting the error in the rate structure which it made in Opinion 546. If the Court should adopt this argument, it would be requiring the Commission to enforce a rate structure which the Commission has found to be contrary to the public interest.

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23. In its present decision the Commission recognized its earlier erroneous treatment of the gas supply problem (II A. 613) and recognized that there is a present critical shortage of gas in the United States (II A. 606). This Court has been made aware of this problem in *F.P.C. v. Louisiana Power & Light Co.*, 406 U.S. 621 (1972).

### 1. The Commission Was Empowered To Reopen The Case

MDG contends that the Commission had no power, after the first "affirmance" by the Court of Appeals, to reopen the case and establish rates higher than those fixed in its first decision. The contention is without merit.[24]

MDG argues as though the case presented the question whether the Commission has power, after an unqualified affirmance of a rate order by a court of appeals, thereafter retroactively to change the rates so made effective and so affirmed. No such question is presented on this record. There was no unqualified affirmance by the Court of Appeals. In its first decision, the court made it "crystal clear" that the Commission should have authority to reopen any part of its orders "including those affecting revenues from gas already delivered" (see p. 6, *supra*).[25] The court's authority to render such a decision, and the Commission's authority to act upon it, is unquestionable, *Ford Motor Company v. National Labor Relations Board*, 305 U.S. 364, 373, 375 (1939). The Court of Appeals has inherent broad equitable powers to fashion appropriate remedies, beyond the incorrect narrow reading which MDG gives to the statutory phrase "affirm, modify or set aside" (*Natural Gas Pipeline Co. of America v. Federal Power Commission*, 128 F.2d 481, 484 (7th Cir. 1942)).

Opinion 546, and the rates proposed thereunder, never became effective. The Commission's order con-

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24. New York advances the same contention, but argues that this Court need not reach the question because there was no evidence upon which to base the changed refund requirements (pp. 17-20). This is incorrect, see part 2, *infra*.

25. The court emphatically reaffirmed that ruling in its present decision (App. C., pp. 30-31, 41-42).

tinuously was stayed by orders of the Commission or the court until withdrawn by the Commission in its second opinion and order (II A. 585).[26] The Commission has the power to change its administrative orders which have not become final because of court review (*United Gas Improvement Company v. Callery Properties, Inc.*, 382 U.S. 223, 229 (1965); *S.E.C. v. Chenery Corporation*, 332 U.S. 194, 200-01 (1947); *Hunt Oil Company v. F.P.C.*, 334 F.2d 474 (5th Cir. 1964)). Thus, there is no element of "retroactivity" as argued by MDG.

The Commission's actions were fully in accord with the lawful judgment of the reviewing court and should be sustained.

### 2. The Commission's Decision To Prescribe A New Rate Structure For Gas Delivered Prior To August 1, 1971 Is Based On Substantial Evidence

Petitioners attack the refund provisions of the Commission's Opinion 598, contending that the earlier Opinion 546 rates are the proper basis for calculation of producer refund amounts for the period ending August 1, 1971. As we have shown, the Commission has the power to

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26. MDG ignores the fact that the Commission's earlier opinion was never placed into effect because of these continuous stays, referring to the refund issues in the later opinion as "already finally decided" (p. 22). To the contrary, the Court stated: ". . . [I]n making this argument the parties ignore, or gloss over, our opinion on rehearing. For there we categorically rejected the notion that the label "affirmance" could possibly impair FPC's ability to alter or modify *any* of the provisions, particularly the refund provisions, of its *SoLa I* rate scheme if it believed that the exigencies of the gas industry required more effective remedial measures" (App. C, pp. 41-42).

set aside Opinion 546. Contrary to New York's assertion, (Br., p. 21) there is substantial evidence demonstrating that "effectuation" of the Opinion 546 rates would be contrary to the public interest.[27]

In Opinion 598 the Commission found no longer proper three basic assumptions upon which its earlier decision (in Opinion 546) was grounded. These assumptions were:

> (a) The ceiling price for flowing gas has little impact on gas supplies, and if the price is based on an average unit cost-of-service calculation with a proper return, the supply will automatically "come forth" to meet the increasing demand (40 F.P.C. 551-52, 646).
>
> (b) An average unit cost of service for the entire gas producing industry in Southern Louisiana can be validly calculated to the second decimal place

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27. In *Permian*, this Court clearly defined the Commission's discretionary powers to determine a producer rate structure in the broadest terms:

> "Section 19(b) of the Natural Gas Act provides without qualification that the 'finding of the Commission as to the facts, if supported by substantial evidence, shall be conclusive.' More important, we have heretofore emphasized that Congress has entrusted the regulation of the natural gas industry to the informed judgment of the Commission, and not to the preferences of reviewing courts. A presumption of validity therefore attaches to each exercise of the Commission's expertise, and those who would overturn the Commission's judgment undertake 'the heavy burden of making a convincing showing that it is invalid because it is unjust and unreasonable in its consequences.' FPC v. Hope Natural Gas Co., *supra*, at 602, 88 L Ed at 345. We are not obliged to examine each detail of the Commission's decision; if the 'total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end.' " (390 U.S. at 767)

(MDG Br., p. 14) based on arbitrary selections of various allocation methods to divide the joint cost of producing oil and gas in at least a dozen steps in the calculation (40 F.P.C. at 590-603).

(c) An average unit cost based on data for a 1960 test year will remain virtually unchanged, "in the foreseeable future" (40 F.P.C. at 637-47; 642-44; New York Br., p. 32).

In *Austral,* the court refrained from substituting its judgment for the Commission's, but was nevertheless extremely skeptical of the validity of these assumptions. It said:

> "[I]f the Commission sets a rate on a cost basis and does not itself consider these questions [relating to the impact of its rates on demand and supply] carefully, its conclusionary statements to the effect that the rate is adequate or that there will probably be no need for changes in the future (these are statements that the Commission has made here) amount only to so much whistling in the dark." (428 F.2d at 444)

Thus, the court authorized the Commission to reconsider these assumptions in the light of further evidence in a reopened record, *as well as all of the evidence in the original record,* and to test their propriety. This the Commission did, and in each instance found the assumption to be invalid,[28] stating:

> "As far as we are concerned, in the prescription of just and reasonable rates, Opinion Nos. 546 and 546-A now perform no office." (II A. 587)

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28. Supply—II A. 601-24; effect of flowing gas price on supply—II A. 624-29; accuracy of cost estimates—II A. 594-97; II A. 630-47; cost trends in the 1960's—II A. 624; II A. 634-35.

The record basis for discarding each of the three basic assumptions provides the undergirding for the Commission's rate structure for the pre-1971 period, as well as the post-1971 rate ceilings.

### A. The Supply And Demand Evidence

*Austral* gave the Commission the unique opportunity to evaluate, in the light of subsequent events disclosed by the reopened record, the basic assumption of Opinion 546 that the ceiling price determined had little impact on natural gas supply or demand[29] and that a "correct" rate of return on an industry average unit cost would automatically generate adequate gas supplies. The "end result"[30] of the philosophy underlying this basic assumption was nothing short of catastrophic.

The supply evidence was thoroughly analyzed by the Commission (II A. 601-17) and by the court (App. C., p. 25). Based on the record evidence, the Commission in Opinion 598 stated:

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29. In Opinion 546 the Commission "was moved to caution" by arguments indicating that higher prices would not increase exploration and development but rather would curtail it by reducing demand, although the Commission did "not accept" this theory in full (40 F.P.C. at 635-36). Under this theory, lower prices would "stimulate supply" by increasing demand. The fact that substantial unsatisfied demand has *not* stimulated exploration and production proves the complete falsity of this concept.

A reading of the section of Opinion 546 entitled "Prices and Gas Supply" discloses a complacency about the supply problem which is almost incredible in the light of today's serious gas shortage (40 F.P.C. at 632-36).

30. The "end result" test has been the consistent standard used by the courts to review decisions of the Commission under the Act. *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944).

> "We thus find a critical shortage of gas in the United States." (II A. 606)

The Commission also expressly repudiated its earlier finding that the supply-trend factor was insignificant (40 F.P.C. 551-52) stating:

> "The evidentiary fact which most concerns us is not in dispute: the traditional trend lines for measuring adequacy of supply, namely, reserves to production (R/P) and findings to production (F/P) ratios, are in a declining mode. In Opinion No. 546 it was stated that the ratio of new supply to net production of natural gas, both in the United States and for the Southern Louisiana area, was not significant in helping to determine reasonable rates [n. omitted]. The statement was erroneous and non-supported, and we now correct it." (II A. 613)

The Court of Appeals also considered the supply question in depth and concluded:

> ". . . [P]roliferating demand has already outstripped a dwindling supply. Thus, there is an increasing gap between supply and demand, and the consumers are feeling, or shortly will feel, the pinch." (App. C, p. 24)

The simple explanation is that economic laws still apply to the gas producing industry, whatever calculations of average unit cost may be adopted as rate ceilings. If the price ceilings are too low, gas producers simply will not be able or willing to invest at a level to replace production. As this Court said in *Permian*:

> "A price is thus just and reasonable within the meaning of §§ 4(a) and 5(a) not merely because

it is 'somebody's idea of return on a "rate-base," ' [n. omitted] but because it results in satisfactory programs of exploration, development and production." (390 U.S. at 796)[31]

### B. The Commission's Findings In Opinion 598 On The Imprecision Of Costs

The second erroneous assumption underlying Opinion 546 dealt with the role of cost estimates in gas producer regulation. MDG would irrevocably lock the Commission into the 18.36 cents per Mcf estimate made in Opinion 546 (Br. p. 24).

The Commission in Opinion 598 stated it was reexamining "*de novo*" the cost analysis for flowing gas (II A. 645). It stated:

> ". . . [C]ost calculations cannot be mathematically precise, but contain arbitrary judgments as to allocation procedures and a wide margin of error in both data and methods utilized." (II A. 630)
>
> * * *
>
> "The assumptions and selections which are possible, using the same data base, are almost unlimited, and the factors so interrelated that errors tend to cumulate." (II A. 632-33)

The court below affirmed these findings, noting that the Commission was "recognizing the wide fluctuations in cost mathematics and the problems of assessment, appraisal and allocation which are so inextricably interwoven

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31. In *F.P.C. v. Louisiana Power & Light Co.*, 406 U.S. 621 (1972) the Court, in the context of the supply problem of a pipeline, spoke of "a pattern of temporary and chronic natural gas shortages throughout the nation" (p. 626).

with the method"[32] (App. C., p. 33, n. 19). The court noted that the "FPC is currently minimizing or at least deemphasizing the use of unit costing as a basis for regulation" (*Id.*).

As long ago as *Permian*, the unreliability of allocation of joint costs was recognized. This Court said:

> "There is ample support for the Commission's judgment that the apportionment of actual costs between two jointly produced commodities, only one of which is regulated by the Commission, is intrinsically unreliable (n. omitted)." (390 U.S. at 804)

In the reopened record, the Commission was presented with four different flowing gas cost studies (II A. 644-47) ranging from the 18.29-cent estimate of MDG's witness to the 24.03-cent estimate of producers' witness. The Commission Staff estimate was 21.18 cents (II A. 647), but did not include the Staff's own recommendation for "normalization" of exploration and development costs, which would add 0.8 cent for a total of 22 cents at a 13 percent rate of return. Contrary to the implications by New York and MDG, the Commission did not adopt the Staff study, or any particular cost study, because of its finding, based on this record, that such costs could not be precisely determined (II A. 595; II A. 631). But the Commission did find that a 15 percent rate of return, not 13 percent, was appropriate for gas producers (II A. 636). Adjusting the Staff's calculation to reflect a 15 percent

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32. To the same effect, see *California v. F.P.C.*, 466 F.2d 974, 985 (9th Cir. 1972) and *Shell Oil Co. v. F.P.C.*, 484 F.2d 469, 478 (5th Cir. 1973, *cert. pending, sub nom., Mobil Oil Corp. v. F.P.C.*, No. 73-438, O.T. 1973).

rate of return, an estimate of 22.21 cents results,[33] which compares quite closely with the Commission's ceiling rate of 22.375 cents for flowing gas.

While acquiescing in the Commission's ceiling rates for periods after August 1, 1971, MDG and New York insist that there is no cost basis for the Commission's rate structure prior to that date, continuing to rely on the discredited cost estimate contained in Opinion 546 (MDG Br., pp. 23-32; New York Br., pp. 26-34) which the Commission has now repudiated (II A. 645). As those petitioners note, the Commission found two specific errors in that estimate; first, the cost estimate for exploration was too low;[34] and second, the 12 percent rate of return was inadequate, and a 15 percent rate of return was more appropriate in the light of the risks undertaken by the gas producers (II A. 636). In the light of its findings on supply and imprecision of costs, the Commission's refusal (II A. 872) to apply these findings to the stale 1960 cost data is not error, see *California v. F.P.C.*, 466 F.2d 974, 985 (9th Cir. 1972).

Petitioners insist that the cost estimates for the 1969 test year in the reopened record should not be applied to

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33. See Appendix A.

34. II A. 645-46. Petitioners disagree on the validity of the changes in the costing method adopted in Op. 598. New York does not contest the Commission's right to adopt improved costing methods and change the rate of return, but insists that it can only be done prospectively (p. 21). MDG (pp. 26-32) argues why its method, which allocates about 20% of the total exploration cost to gas and 80% to liquid hydrocarbons, is superior to the Commission's which allocates about 45% to gas and 55% to liquid hydrocarbons. Aside from the fact that under the *Permian* review standard the Commission's judgment should control on issues of this type, we have previously shown that the "end result" of MDG's approach is inadequate exploration directed to gas reservoirs.

the period 1961 through 1971 (MDG Br., pp. 24, 31; New York Br., pp. 21-22), but they fail to explain why a 1960 test year is more appropriate for this period. In fact, experienced costs were trending upward during this period (see discussion, *infra*).

The Commission's rate structure fully conforms with this trend (II A. 653-54). The Commission squarely found:

> "There is an adequate cost basis for the results we find to be just and reasonable and in the public interest." (II A. 601)

### C. The Evidence Of The Increasing Cost Trends From 1960 To 1971

The third erroneous assumption underlying Opinion 546 was the concept that 1960-based cost estimates would remain unchanged. Similarly, MDG alleges that there was not any real increase in historical costs (Br., p. 24).

The record contains substantial evidence supporting the Commission's conclusion that producer costs were trending upward from 1961 to 1971, directly refuting the earlier conclusion in Opinion 546 that unit costs will not rise "in the foreseeable future" (40 F.P.C. at 637-38).

Estimates of flowing gas costs in the record show that producers were experiencing higher costs than the costs estimated in Opinion 546 using a 1960 test year, and such costs were on an increasing trend throughout the decade of the 1960's. Three alternative costing methods were submitted, all showing increasing cost levels between 1960 and 1962 (V A. 176e; *see also* IV A. 597-601 and V A. 211e).

An additional presentation showed increasing cost trends by backtrending current cost estimates.[35] Estimates utilizing the Commission's *Permian* method for estimating the current cost of new gas on a year by year basis showed the continuing increase in unit cost over the time period 1961 through 1968 (V A. 199e-200e):

| | 13 Percent Rate of Return | 16 Percent Rate of Return |
|---|---|---|
| 1961 | 22.12¢ | 24.50¢ |
| 1962 | 21.68 | 24.01 |
| 1963 | 23.23 | 25.72 |
| 1964 | 23.49 | 26.07 |
| 1965 | 23.92 | 26.54 |
| 1966 | 26.79 | 29.70 |
| 1967 | 28.69 | 31.86 |
| 1968 | 29.82 | 33.13 |

The record also contains evidence of steadily increasing drilling costs per foot for the period 1963 ($17.33) through 1969 ($25.48) (V A. 192e). In Opinion 598, the Commission noted:

> "With respect to drilling costs per foot, we find a pronounced trend toward deeper drilling which augments the general price inflation. (II A. 635)
>
> * * *
>
> "The magnitude of the industry's capital requirements has continued to increase [n. omitted], and, the costs of producing natural gas have continued to climb. (II A. 624)

35. The Commission in *Permian* used a similar method as a check on its historical cost estimates (34 F.P.C. at 219, V A. 212e). This page of the record (V A. 212e) was inadvertently omitted from the Joint Appendix. It is attached hereto as Appendix B.

Thus, the third major premise on which Opinion 546 was based, the assumption that exploration and production costs had remained constant and could be expected to continue to remain so (40 F.P.C. 637-38), was repudiated by the Commission in Opinion 598.

The Commission's new findings on these three major issues, based on evidence in the reopened record constitute the "reasoned findings" and record support for its decision to withdraw Opinion 546 and to adopt a new rate structure, including the refund discharge component of that structure.

### 3. The Refund Discharge Provision Is Supported By Substantial Evidence

The evidence in the record clearly would support a finding by the Commission that no refunds at all should have been required. There is record demonstration that the revenues received by the producers for gas production from the Southern Louisiana Area were less than the costs incurred in finding and producing this gas on an industry-wide basis,[36] a ground which this Court in *Wisconsin v. F.P.C.*, 373 U.S. 294, 306 (1963) found sufficient to excuse refunds. The Commission's Staff witness reached this conclusion and recommended that no refunds be required (IV A. 686, 693).

As the court below pointed out, the Commission is not required to order refunds and is empowered to structure any refund order in a manner which "will fairly balance

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36. Average revenues received for the period 1960-70 under the Commission's decision were 19.63¢ per Mcf (V A. 237e). In contrast, estimated costs for this period ranged up to 27-30¢ per Mcf (V A. 239e).

the public interest" (App. C, pp. 43-44).[37] In the light of the foregoing, it cannot be said that the Commission's refund order constituted an abuse of discretion.

Petitioners treat the refund discharge provision (and in particular the price ceilings which underlie the refund obligation authorized to be discharged by this method) as a separate entity, not an integral part of the rate structure, and then contend it is without record support when viewed in isolation (New York Br., pp. 40-41; MDG Br., pp. 44-49). The Commission certainly did not so regard it:

> "[C]ontrary to New York's position, we have stated that the twenty-six cent rate (with which they purport to agree) is merely one element in a complex rate design package. Furthermore, refunds as a part of that package represented a policy decision; if such a policy decision had not been made as it was, the price for new gas might well have been greatly higher." (II A. 870)

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37. Arguments similar to those made by petitioners were rejected in *California v. F.P.C.* (the *Hugoton-Anadarko Area Rate* Case), *supra*:

> "As the Commission points out, section 4(e) of the Act, 15 U.S.C. §717c(e), does not require refunds where unlawful rates have been collected in prior years, but leaves this to the discretion of the Commission. The view that the Commission's refund power is discretionary has support in the court decisions. In *Permian*, 390 U.S. at 767, 88 S.Ct. 1344, 20 L.Ed.2d 312, the Supreme Court made it clear that the Commission is free, within the limits imposed by pertinent constitutional and statutory commands, to devise methods of regulation capable of equitably reconciling diverse and conflicting interests. In exercising this discretion it is 'the duty of the Commission to look at "the backdrop of the practical consequences . . ."' of its refund order." (466 F.2d at 990-91, nn. omitted)

On rehearing the Commission repeated this concept and added:

> "Determining flowing gas prices, new gas prices, refunds, and incentives as we do herein, is preferable to the alternative urged upon us of loading all the burden of the required new incentives on higher prices for 'new gas' only." (II A. 588)

If the Commission, instead of designing its rate structure with a base ceiling rate plus refund credit, had merely raised the ceiling rates sufficiently to eliminate the refunds entirely, no petitioner could contend that it had exceeded its discretionary powers, or that substantial evidence in the record did not support its actions.

The Commission cited another valid and important reason for not requiring the refunds to be made immediately in cash. In the light of the supply crisis, the Commission voiced its concern at the "inadequate capital formation in the natural-gas producing industry." (II A. 624)

In *Austral* on rehearing, the Fifth Circuit had specifically enjoined the Commission:

> "[I]t may be that the refunds are too burdensome in light of new evidence to be in the public interest. In that case, it is our judgment that the Commission shall have the power and the duty to remedy the situation by changing its orders." (444 F.2d 127)

The Commission found and the Court of Appeals affirmed that internally generated funds provided "additional and needed, internal capital available for expenditure in the search for new gas reserves" (App. C, p. 32). The withdrawal of $150 million of required refunds from gas producers' capital all at one time obviously would have

a substantial impact on exploration budgets. At the same time the work-off provision encourages the use of additional funds for exploration efforts, which if successful would discharge the obligation once and for all. The Fifth Circuit held:

> "Given the financial posture of the various producers, and taking full account of the consumer interests, FPC had the right to conclude that it was more in the interest of the consumers for the producers to keep those funds which were paid in the past than to pay an even greater rate in the future. And given that possibility, we cannot say that FPC erred in adopting the refund provisions it did." (App. C, pp. 44-45)

### 4. The Contingent Escalations In The Flowing Gas Rates Are Supported By Substantial Evidence

Petitioners all attack that portion of the Commissioner's order which provides contingent escalations in the price of flowing gas. The criticisms include (i) MDG's argument that "nothing more could possibly be needed" because new exploration is generated only by the prices for new gas (MDG Br., pp. 34-35); (ii) flowing gas incentives are "contrary to traditional utility concepts" which require stockholders and not consumers to supply needed capital (MDG Br., pp. 36-37); and (iii) the contention that contingent escalations of flowing gas prices may be permissible but the amounts fixed by the Commission here are without evidentiary support (New York Br., pp. 35-40).

The view that traditional concepts of utility regulation must govern producer ratemaking has long been dis-

credited.[38] Indeed, it was upon this misconception that early regulation of gas producers foundered.[39] Nor is there merit in the contention that the Commission was without power to encourage new supplies of gas by incentive increments to flowing gas prices (II A. 624-25).[40] As the court below pointed out (App. C, p. 32) the Commission could properly consider the fact that an increased rate for flowing gas would generate internal capital available for expenditure in the search for new gas. And the inclusion by the Commission of incentive factors in the rate structure, in recognition of this fact, has the approval of this Court.[41]

These flowing gas escalations are also cost-supported. A Commission Staff witness testified that the inflation[42] rate

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38. See the opinion of the court below (App. C., pp. 32, 44). In *Permian* this Court said (390 U.S. at 756-57): "Producers of natural gas cannot usefully be classed as public utilities. They enjoy no franchises or guaranteed areas of service. They are intensely competitive vendors of a wasting commodity they have acquired only by costly and often unrewarded search. . . . The exploration for and the production of natural gas are thus 'more erratic and irregular and unpredictable in relation to investment than any phase of any other utility business'" (n. omitted).

39. *Permian*, at pp. 758, *et seq.* And see the opinion of the court below (App. C, p. 6, *et seq.*).

40. Petitioners throughout are blind to this Court's admonition that:

> "A price is thus just and reasonable within the meaning of §§4(a) and 5(a) not merely because it is 'somebody's idea of return on a "rate base,"' (n. omitted) but because it results in satisfactory programs of exploration, development and production." (*Permian*, 390 U.S. at 796)

41. *Permian*, 390 U.S. at 796-98.

42. In the *Hugoton-Anadarko* case, *California v. F.P.C.*, 466 F.2d 974, the Ninth Circuit sustained a similar fixed escalation on the basis of "changes in the economic climate, as evidenced by persistent inflationary trends in the general economy, unusual 'liquidity' pressures on corporate enterprises, and increased prime and bond interest rates" (466 F.2d at 989).

alone had increased industry costs at about four percent per year over the period 1966 thru 1970 (IV A. 689) and estimated "on a conservative basis" a future cost increase of about two and one-half percent per annum or one-half cent per Mcf per year (IV A. 692).[43] Contrary to petitioners' arguments, increased costs do affect flowing gas and higher prices make possible greater recovery from existing wells (III A. 361-62). Trends in producer costs may be expected to continue to increase over the period covered by the moratorium on rate increases (see Part 2, *supra*).

Petitioners also urge that the evidence does not support a finding that the increments in price will elicit the anticipated additional supply. The Commission had before it extensive testimony concerning the gas shortage and estimates of the new supply needed to alleviate the problem (II A. 601-24); economic and cost evidence in support of rate levels needed to induce additional supply (II A. 617-48); the amount of capital required to develop additional supply (II A. 624-30) and the need for a higher price to stimulate production of additional supply (II A. 617-24). Upon the basis of this testimony the Commission reasonably concluded that the increments would indeed provide an incentive for the exploration and development of gas reserves in the Southern Louisiana Area. And the same testimony supplied the Commission with a logical range of alternatives for

43. The current inflation rate is about 9.4% per year. Consumer Price Index, Bureau of Labor Statistics, Department of Labor, Press Release, February 22, 1974.

selecting the increments and the levels at which they would become effective.[44]

After a consideration of the extensive evidence relating to the gas shortage and the influence of price upon supply, the Commission established specific price incentives in the rate structure which are to become effective only upon the dedication of substantial new supplies of gas to the jurisdictional market.[45]

It is clear, we submit, that the contingent escalations fall within the zone of reasonableness within which the Commission may function in its regulatory capacity.

### 5. The Rate Structure Prescribed By The Commission Is Not Unduly Discriminatory

The refund discharge and contingent escalation provisions of the Commission's rate structure is singled out for particularly sharp attack by all petitioners. Because of the emotional intensity of these charges and the extent of their repetition (MDG Br., pp. 46-49; New York Br.,

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44. The *in terrorem* tactics employed by New York (p. 35) and MDG (p. 52) in quoting astronomical dollar impacts should be ignored. The Court is well aware that changes in ceiling prices do not alter contract limitations and that *average* revenues lag behind ceiling prices (390 U.S. at 818, 822). The record here demonstrates that a 2¢ per Mcf ceiling price increase (from 22¢ to 24¢) impacts average revenues only 1¢ per Mcf (from 21.15 to 22.18) and a further 4¢ per Mcf ceiling price increase impacts average revenues only an additional 1¢ (from 22.18 to 23.21) (V A. 271e).

45. MDG (pp. 38-41) and New York (pp. 25-26) demand that the Commission exact firm assurances that any portion of the flowing gas ceiling rate ascribed to "non-cost" or "incentive" factors be earmarked for additional exploration in the area, and then attack the very provision of the Commission's rate structure which does exactly that; *i.e.*, the contingent escalation provisions.

pp. 40-43 and Mobil Br., pp. 34-56), certain fundamental principles obfuscated by petitioners' arguments, are restated as follows:

(a) As approved by this Court in *Permian*, the area rate method does not purport to place every producer and every consumer on an equal basis. Every producer's cost position and contract position is different (390 U.S. 769). The only way each producer can be placed on an equal regulatory footing is to institute a separate rate case for each one, consider his individual costs and revenue return, and calculate an appropriate return. In fact, in the first six years after *Phillips I*,[46] this is exactly what the Commission attempted to do. When this effort bogged down in an impossible administrative morass, the Commission turned to the area rate method, which admittedly penalized the high-cost producer (390 U.S. at 757-58; 769-70). This Court affirmed this approach against charges of "undue discrimination" similar to those raised here,[47] on public interest grounds.

(b) Where the gas producing industry is in a revenue deficient position,[48] refunds are not required,

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46. *Phillips Petroleum Co. v. Wisconsin*, 347 U.S. 672 (1954).

47. See discussion in Justice Douglas' dissent in *Permian*, 390 U.S. at 829-37.

48. The record shows an average unit realization by the industry under the UDC Settlement Proposal of 19.63¢ for an average of the years 1963 through 1970 (V A. 237e). This realization was less than all but the lowest range of cost for the same period (V A. 239e); Staff's rate design witness reached a similar conclusion and recommended no refunds (IV A. 686; IV A. 693).

even of individual rates collected above the prescribed "ceiling rate" (*Wisconsin v. F.P.C.*, 373 U.S. 294 (1963)).

In deciding whether to order refunds, the Commission may consider the equities on the side of both the producer paying the refunds and the consumer receiving them, *Continental Oil Co. v. F.P.C.*, 378 F.2d 510, 532 (5th Cir. 1967); *Public Service Commission of New York v. F.P.C.*, 329 F.2d 242, 250 (D.C. Cir. 1964), *cert. denied sub nom. Prado Oil & Gas Co. v. F.P.C.*, 377 U.S. 964 (1964); *Mesa Petroleum Co. v. F.P.C.*, 441 F.2d 182, 192 (5th Cir. 1971);[49] and *California v. F.P.C.*, 466 F.2d 974, 990-91 (9th Cir. 1972).

(c) This Court has held the Commission has the power to divide the producers into categories and prescribe different rates for different "vintages" of gas, even though these categories may perform the same functions and the gas may be indistinguishable as to quality and value (390 U.S. at 787).

In the light of these broad limits of discretion, petitioners must face the question: "Where lies the reversible error?"

### A. The Refund Work-Off Provisions

All three petitioners join in attacks against those provisions which permit refund obligations to be worked off by the dedication of new reserves. Mobil is concerned

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49. New York's attempt to explain away *Mesa* (Br., p. 35) misses the point for which it was cited by the court below. At 441 F.2d, p. 192, the court required the Commission to "forgive" 37.5% of the refund, to avoid discrimination against petitioner.

chiefly with a claimed discrimination among producers; New York and MDG, with alleged discrimination against purchasers.

Mobil's complaint arises from the fact that it discharged most of its refund liability in an individual company settlement before the final decision below. Mobil alone, of the many producers[50] who entered into individual settlement agreements, now argues that it is aggrieved by the "undue discrimination" arising from the fact that the final order of the Commission permits the producers who did not settle to work off their refund obligation by contributing reserves instead of paying cash[51] but this "discrimination" arises solely from Mobil's voluntary settlement. Under its settlement Mobil was allowed to retain $14.6 million of the moneys it had collected subject to refund, or approximately 55 percent of its total refund exposure up to January 1, 1967 (see 31 F.P.C. 1101, 1105). It has no basis to complain now because it voluntarily negotiated a settlement at rates which were different than those finally established.

The Mobil individual settlement provided for a moratorium against rate increase filings above the agreed settlement levels until January 1, 1967, whereupon Mobil was authorized to refile rate increases to contract levels. Mobil did not file such increases prior to the issuance of

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50. A list of the settling producers, with citations to the reported settlements, appears in the opinion of the court below (App. C, pp. 46-47, n. 31). A number of these producers are parties to this brief.

51. It is noteworthy that Mobil's average revenues resulting from application of the settlement proposal are higher than 19 out of the 23 largest sellers of gas in Southern Louisiana and are above those of the nonsettling producers (V A. 235e, reproduced herein as Appendix C).

Opinion 546 (October 1, 1968), which prohibited their filing (See *Mobil Oil Corporation v. F.P.C.*, 469 F.2d 130, 133 (D.C. Cir. 1972) *cert. denied* ____U.S.____, 37 L.Ed.2d 159-60). Had Mobil acted diligently and refiled its rate increases at the time its moratorium under its individual company settlement expired, it would now be in much the same position as the other producers supporting the Commission's Opinion 598.

As the Commission said in answering Mobil's contention:

> "Parties who enter into settlements or those who refuse to do so, always run the risk that the ultimate Commission determination may be higher or lower than the settlement levels." (II A. 644)

And the Court of Appeals pointed out (App. C, p. 47, n. 31):

> "If the SoLa II rates were lower than those established in these agreements, the private settlements would have been worthwhile. As it turns out, FPC was more generous in SoLa II than was anticipated. But this clearly furnishes no basis for attack."

The arguments of New York and MDG place emphasis upon an alleged discrimination as to purchasers. The contention is that the refund order is discriminatory because it permits producers to work off refunds by dedicating up to 50 percent of the new reserves to purchasers other than those to whom the refunds would otherwise be payable. The court below held that it was within the realm of administrative discretion, under the teachings of *Permian*, to treat the refund benefit on an area-wide basis. The record shows that two-thirds of the refund

obligations are owed to 3 of the 14 pipeline companies serving the Southern Louisiana Area (V A. 281e). Under the discretionary power of the Commission to formulate rates on an area-wide basis it cannot be reasonably contended, that the Commission abused its discretion in guaranteeing that 50 percent of the new reserves must be sold to these three companies but that other purchasers may share in the balance. No one's money is given away, for the obligation remains. The only question is whether the obligation will be discharged by payment of money or commitment of gas. The dedication of at least 50 percent of the new reserves to the three companies, particularly in today's market, may well exceed in benefit the amount of the refunds. But in any event the pipeline companies do not complain.

Nor does New York or MDG show that the consumers served by pipelines in the area of either will suffer. Contrary to the implications of MDG (pp. 47-48), a large number of municipal gas distributors, in the market area of those pipelines to whom the refunds are owed, also supported the settlement proposal approved by the Commission in Opinion 598.[52] The Public Service Commissions of Indiana, Mississippi, and Kentucky all filed pleadings with the Commission supporting the settlement proposal.[53] If the refund work-off provisions were really as discriminatory against consumers as petitioners allege, it is not logical to expect the proposal to have been supported by consumer groups throughout the entire market area for Southern Louisiana.

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52. A list of these municipal distributors is attached hereto as Appendix D.

53. See Appendix E attached hereto.

Finally, petitioners contend that the benefits of the work-off provision of the refund order accrue entirely to present producers in the Southern Louisiana Area, thereby "imperiling the entry of new producer entrants and giving a competitive advantage to producers who had charged the most unreasonable rates in the past" (MDG Br., p. 47).[54] The court below (answering this attack upon the contingent escalation provisions of the rate order as well as the refund work-offs) pointed out:

> "And for that unnamed new market entrant for whom much concern is expressed, we fail to see why he would be in the least bit dissuaded from committing new reserves at 26¢/Mcf by the fact that it might allow some of his competitors to raise their 22.375¢/Mcf flowing gas price by a half-penny." (App. C., p. 51)

### B. The Incentive Provisions In The Rate Structure

Petitioners also charge that the one-half-cent incentive increases on flowing gas are discriminatory.[55]

The principal attack by petitioners is directed at the "contingent" escalation, and at the fact that the Commission avoided a "double count" of new reserves commitments by providing that if a new reserve was utilized

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54. In any event, this argument is devoid of any factual basis. In contrast, as shown by Appendix F hereto, offshore Louisiana lease sales since the issuance of Opinion 598 have shown remarkable growth in the number of successful bidders, including new entrants. It is also noteworthy that Mobil's participation seems undiminished—particularly in relation to those companies whom it accuses of receiving undue benefits from the Commission's decision.

55. Petitioners' arguments are confusing; if it is correct that new exploration is generated only by new gas prices (MDG Br., pp. 34-35), then incentive increases in flowing gas prices cannot discriminate against new entrants who conduct only new exploration.

by a producer to discharge refunds under the refund discharge provision, the same reserves could not also be counted toward triggering the contingent escalation. We fail to see how a provision which ties revenue increases *from this area* directly to a requirement for dedication of new gas reserves *in this area* as a part of the total rate structure is so objectionable because all producers may not contribute equally to the new reserves, or all consumers benefit equally from them. We submit that any attempt by the Commission to achieve such perfection is doomed to failure by the obvious complexities of the industry, and the uncertainties of gas exploration.

The escalation in price operates equally upon all producers as an incentive to contribute to the total reserves which will trigger the increased price. The possibility that some producers (and certainly these would not be the large producers, as New York suggests, Br., p. 39) may not invest additional capital, or that other producers may do so but be unsuccessful and thus contribute no new reserves, are but facets of area-wide pricing which need take into consideration only just and reasonable overall incentive provisions in the price.[56]

On the producer side, an individual producer may invest millions of dollars in exploration funds and find absolutely nothing. A second producer may make a small investment to attempt to discharge his refund obligation and find a major gas field, contributing vast new gas reserves to the "reserves fund" to the benefit of all producers. On the consumer side the finding of additional gas supplies obviously benefits all the consumers, even though the Commission did not attempt the impossible

56. *Permian* at 797-98.

task of tracking payments through into new reserves back to the same group paying the increase.

### 6. Other Arguments By Petitioners Do Not Present Reversible Error

Petitioners' briefs raise a variety of additional challenges to the Commission's orders. None of these arguments raises a serious question which would merit disturbing the opinion below.

#### A. Pipeline Transportation Rates

In its orders the Commission prescribed a charge to be made by interstate pipelines transporting for the account of producers liquids and liquefiable hydrocarbons within pipeline facilities in Southern Louisiana (II A. 650-51, 660-61). These rates are stated as minimum charges, which do not apply so long as the parties, by private contract, agree to transportation rates at levels equal to or above such rates. This transportation occurs most often from offshore production platforms to points onshore where liquids are separated from the gas stream and liquefiable hydrocarbons are removed in processing plants.

Mobil contends that these minimum rates are unreasonable and unsupported by substantial evidence in this record.[57] In prescribing the levels for transportation

57. Mobil notes (Br., p. 76) that the U.S. Court of Appeals for the District of Columbia Circuit in *Mobil Oil Corp. v. F.P.C.*, 483 F.2d 1238 (1973) held, *inter alia*, that the Commission lacks jurisdiction over the sale or transportation of liquids. That opinion and judgment have become final and are no longer subject to further judicial review. Mobil did not raise the issue of jurisdiction in this case so that such issue is not before this Court. In recognition of this fact, Mobil's argument is confined to questions of the substantiality of the evidence upon which the Commission prescribed the rate levels (Br., p. 76).

of liquids and liquefiable hydrocarbons the Commission relied upon the testimony of two witnesses (IV A. 605-16). Mobil had opportunity to and did cross-examine these witnesses.

The Commission, relying upon this testimony, found that "ample support" existed for the minimum rate levels prescribed for pipeline transportation (II A. 650-51).

Mobil erroneously states that the court in *Mobil Oil Corporation v. Federal Power Commission,* 483 F.2d 1238 (D.C. Cir. 1973) found the evidence presented in the record below to be insubstantial (Br., p. 80). In contrast, in the D.C. Circuit case, rates for similar pipeline transportation of liquids and liquefiable hydrocarbons for the entire nation were being considered in a separate proceeding through informal rulemaking procedures. The Court of Appeals found that the Commission's reliance upon the aforementioned evidence, incorporated from this record, without notice to the parties, or an opportunity for rebuttal, created an insufficient record on which to review the reasonableness of the Commission's action. Thus, with respect to liquefiable hydrocarbons the court in that case stated:

> "As the record stands in reviewing the Commission's action we are unable to decide whether its actual determinations are supported by substantial evidence. . . ." (483 F.2d 1238, 1259)

Since adversary proceedings were followed in this case, producing an adequate record, the Commission's decision on transportation of liquids and liquefiable hydrocarbons should not be disturbed.

### B. The Settlement Proposal As A Basis For Resolution Of This Case

As previously noted, the rate structure and other incentive features of the Commission's order originated as a proposed settlement of the case initiated by a group of gas distribution companies, the United Distribution Companies group (UDC).

Opposition to this settlement proposal came from both ends of the spectrum. Mobil and Amoco Production Company, two gas producers, objected to the settlement for varying reasons, many of which are reflected in Mobil's brief in this proceeding. On the other hand, the Municipal Distributors Group and New York objected, also for reasons outlined in their briefs herein. Irrespective of these objections, however, the court below concluded that there was a "broad base of support" for such settlement which included the vast majority of those interested in the production, transportation and distribution segments of the gas industry together with the Commission Staff itself.

The court below enunciated the following principle for disposition of settlement proposals:

> "If a proposal enjoys unanimous support from all of the immediate parties, it could certainly be adopted as a settlement agreement if approved in the general interest of the public. But even if there is a lack of unanimity, it may be adopted as a resolution *on the merits*, if FPC makes an independent finding supported by 'substantial evidence on the record as a whole' that the proposal will establish 'just and reasonble' rates for the area." (emphasis by the court) (App. C, pp. 20-22)

These are precisely the principles followed by the Commission in this case (II A. 594).

The law is settled that the Commission not only has the power but the duty to consider a settlement proposal tendered in a proceeding, which fails to receive unanimous support, as a possible disposition of issues in the proceeding on their merits (*Michigan Consolidated Gas Co. v. F.P.C.*, 283 F.2d 204, 224 (D.C. Cir. 1960), *cert. denied* 364 U.S. 913; *cf. Pennsylvania Gas & Water Co. v. F.P.C.*, 463 F.2d 1242, 1246 (D.C. Cir. 1972); *Amoco Production Co. v. F.P.C.*, 465 F.2d 1350, 1355 (10th Cir. 1972); *Cities of Lexington, Ky. v. F.P.C.*, 295 F.2d 109, 121 (4th Cir. 1961); *In Re Hugoton-Anadarko Area Rate Cases*, 466 F.2d 974, 980 (9th Cir. 1972))[58] No party to this proceeding disputes this point. Rather, New York argues that (1) the Commission was over-awed by the broad gauge support for the UDC settlement proposal and gave it undue consideration as a disposition of the case on its merits, and (2) that the Commission accepted this settlement proposal on an "all or nothing" basis so that some portions of the settlement were accepted without substantial evidentiary support (New York Br., pp. 45-48). While not challenging as aggressively as New York, Mobil argues that the Commission simply accepted this settlement proposal without regard to the evidentiary record before it (Br., p. 55).

The Commission made this settlement proposal a part of its record. All parties, including New York and Mobil, were given an opportunity to present evidence with regard

58. The power of other agencies operating under the A.P.A. to approve a settlement in the absence of an agreement by all parties, even without a hearing, has been sustained (*Local 282, International Bro. of Teamsters v. NLRB*, 339 F.2d 795 (2d Cir. 1964)).

thereto (II A. 590). The Commission concluded "Only if substantial evidence supports it can we approve the settlement proposal. . ." (II A. 594). No higher standard is required.

New York also argues that the Commission gave undue consideration to the settlement proposal as a resolution on the merits because of the broad support which it enjoyed. Even though the settlement had the active endorsement of an overwhelming majority of consumer, pipeline and producer interests[59] New York argues (without precedential basis) that the status of the settlement in the proceeding was essentially that of a brief, carrying no special weight or significance (New York Br., p. 46).

It is axiomatic that the law encourages and favors the compromise and settlement of disputed claims and a settlement, if fairly made, will be sustained (15A C.J.S., *Compromise & Settlement*, §23 (1967)).[60]

The legislative history of Section 5(b) of the Administrative Procedure Act (5 U.S.C. § 554) specifically demonstrates that an agency shall give all interested parties opportunity to present offers of settlement and that use of the settlement process is encouraged (*See Cities of Lex-*

59. Both the Commission and the court below cast the distributor groups supporting the proposal as representatives of the consumer interests (II A. 589). New York disputes this (Br., p. 47) by arguing that a position for lower rates which it espouses is the only legitimate consumer interest viewpoint. As New York's brief concedes, however, distribution companies are also interested in securing a reliable supply of gas for their customers. Lower prices without an adequate supply of gas do not protect consumers. New York focuses unduly on lower prices without adequate consideration of gas supply.

60. In *Austral* the court of appeals recommended the settlement process to the Commission for resolution of this proceeding (428 F. 2d 407, 434, n. 86)

*ington, Ky. v. F.P.C.*, 295 F.2d 109, 121 (4th Cir. 1961)).[61]

From the foregoing, it is clear that there are strong public interest reasons for encouraging settlements and utilizing this vehicle for resolution of complicated public interest issues, where overwhelming support for this procedure is evident as in this proceeding. To heed New York's argument would be to effectively deny the Commission the use of this important administrative technique. The Commission was entitled to give significant weight to the UDC settlement proposal.

### C. Casinghead Gas

Casinghead gas is natural gas produced simultaneously and in conjunction with crude oil. In this and contemporaneous proceedings the Commission has eliminated any price distinction between this natural gas and natural gas produced separately from crude oil so far as new dedications are concerned. New York alone raises an issue that such price treatment was error (Br. pp., 43-45).

The court below found that several considerations supported the Commission action: (1) "the exigencies of administration demand the smallest possible number of separate area rates" (quoting *Permian* at p. 761); (2) there is a serious problem of allocating exploration

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61. The Commission explained:
"[W]e have both a duty and legal obligation to give consideration to a settlement proposal. As indicated by our rules, Section 1.18, Settlement conferences may be held at any time prior to or during such hearings. Likewise, the Administrative Procedure Act specifically provides that an agency shall give all interested parties opportunity for offers of settlement." (II A. 590-91)

and development expenses between oil and gas;[62] (3) a lower price on casinghead gas invites diversion to the intrastate market; and (4) an economically unfeasible price on casinghead gas encourages its flaring rather than marketing.[63]

The Commission here referred to its rationale in the *Texas Gulf Coast* Opinion (II A. 651) that:

> "[A]s a matter of economic principle, it appears to be more desirable to establish a single price structure for future dedications of both commodities rather than to continue with a doctrinaire concept with insubstantial economic justification." (*Texas Gulf Coast Area Rate* Decision, 45 F.P.C. 711-12)

The selection of the form of rate structure is a "pragmatic" choice which this Court has left to the Commission. In *Permian* the Court affirmed the Commission's decision to price casinghead gas at the same rate as gas-well gas for past periods on the basis of the need for "simplified and

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62. New York strongly relies on the now-discarded Opinion 546, but neglects to note that even there the Commission recognized:

> "[T]he casinghead gas cost result finally derived is too imprecise, in our judgment, to be used as a meaningful measure for pricing purposes." (40 F.P.C. at 557-58)

The argument that the cost of casinghead gas is less than gas-well gas (New York Br., p. 44) rests on the assumption that the preponderance of the joint cost of oil and casinghead gas should be allocated to oil, because the unregulated price of oil is higher. This is clearly a circular argument.

63. In its Opinion on Rehearing the Commission stated:

> "We note, again, that the Btu content of casinghead and gas-well gas is about the same, and the record shows that substantial volumes of casinghead gas are being flared in Southern Louisiana —reason in itself for eliminating the price discrimination." (II A. 871)

realistic area price regulation" (390 U.S. at 803). Under the same rationale, the Court should affirm here.

### D. The Commission's New Gas Rates

The only challenge with respect to the prospective operation of the rate levels set by the Commission in this case is raised by Mobil, which contends that such rates are too low.[64] Mobil attacks the rate determinations on the principal basis that the new gas ceiling price was set at an insufficient level because of other incentive features of the Commission's order, particularly the refund discharge provision (Br., p. 60).

Mobil's argument in essence is a collateral attack upon the refund discharge provision which, as hereinbefore demonstrated, represents a lawful exercise of the Commission's regulatory discretion. As indicated in the Commission's findings, substantial evidence as to cost and economic factors contained in the record of this proceeding support the Commission's conclusions with respect to the new gas price.[65] Mobil's quarrel, therefore, is really with the Commission's judgment to seek gas supply elicitation in the context of the entirety of the Southern Louisiana rate structure, not just the new gas price. This determination is the office of the Commission and should not be disturbed.

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64. While New York objected to the flowing gas rate level as being too high in the court below, in the present review proceeding it raises no such complaint (Br., p. 11). Similarly, MDG disputes the flowing gas rate level only with respect to the calculation of refunds (Br., p. 23, *et seq*).

65. See *e.g.*, II A. 607, 618, 619, 629, 631-42.

## CONCLUSION

The Commission has continued its evolution of producer rate regulation in the decision below, within the bounds of discretion authorized by this Court in *Permian*. Specifically, the Commission has found its earlier opinion to be erroneous, because it was based on findings which were incorrect. The Court of Appeals has construed its earlier decision permitting, and even inviting, the result the Commission has now reached. This Court should affirm the Commission's correction of its former errors, and its adoption of a rate structure which the Commission found to be in the public interest.

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## CERTIFICATE OF SERVICE

The foregoing Brief of Respondents Exxon Corporation, *et al.* has been served in accordance with Rule 33 by mailing three (3) copies thereof, postage prepaid, to all counsel of record and to the Solicitor General of the United States this 2nd day of April, 1974.

/s/ _____
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*Exxon Corporation*

# APPENDICES A - F

## APPENDIX A

### SOUTHERN LOUISIANA AREA
### FLOWING GAS COSTS @ 15% RETURN
### YEAR 1969

| Line | | Cents per Mcf |
|---|---|---|
| 1 | Cash expense | 1.81 |
| 2 | DD&A | 4.00 |
| 3 | Return at 15% | 6.30 |
| | Total production cost | 12.11 |
| 5 | E&D expense | 5.47 |
| 6 | E&D return @ 15% | 1.27 |
| 7 | Total E&D cost | 6.74 |
| 8 | Total @ 14.73 psia | 18.85 |
| 9 | Total @ 15.025 psia | 19.23 |
| 10 | Gathering cost | 0.51 |
| 11 | Regulatory expense | 0.17 |
| 12 | Production tax | 2.30 |
| 13 | Total | 22.21 |

Source: Testimony of FPC Staff Witness Engel (IV A. 688) Opinion 598 (II A. 646) except that the return has been converted to 15% on lines 3 and 6.

## APPENDIX B



### SOUTHERN LOUISIANA AREA
### ESTIMATED FLOWING GAS (VINTAGE 1) COSTS
### BY SUBSTITUTION OF CURRENT COST
### DD&A AND E&D
### 1969

| Line | | Unit cost: Low range (a) | Unit cost: High range (b) |
|---|---|---|---|
| | Production costs: | | |
| 1 | Cash expenses | 1.93¢ | 1.93¢ |
| 2 | DD&A | 7.53 | 9.18 |
| 3 | Return allowance | 5.71 | 5.71 |
| 4 | Total | 15.17 | 16.82 |
| | Exploration and development costs: | | |
| 5 | Expenses | 5.45 | 7.35 |
| 6 | Return | .62 | .62 |
| 7 | Total | 6.07 | 7.97 |
| 8 | Subtotal @ 14.65 | 21.24¢ | 24.79¢ |
| 9 | Conversion to 15.025 | 21.78¢ | 25.42¢ |
| 10 | Regulatory expense | .17 | .17 |
| 11 | Gathering costs | .51 | .51 |
| 12 | Production taxes | 2.30 | 2.30 |
| 13 | Total costs @ 12% return | 24.76¢ | 28.40¢ |
| 14 | Total costs @ 13% return | 25.30¢ | 28.94¢ |

Source: Opinion 546 (34 FPC 603) except for DD&A and E&D expenses which are from Dr. Stephen Sherwin's Exhibit No. _____ (SFS-1) adjusted to exclude liquid credit and royalty, and adjusted for pressure base.

# SOUTHERN LOUISIANA AREA
## ESTIMATED FLOWING GAS (VINTAGE 1) COSTS BY BACK TRENDING
## DR. STEPHEN SHERWIN'S CURRENT GAS COST PER EXHIBIT ____ (SFS-1)
## 1969

| Line | | Low range | | | High range | | |
|---|---|---|---|---|---|---|---|
| | | Current cost (a) | Back trend adjustment (b) | Back trended cost (c) | Current cost (d) | Back trend adjustment (e) | Back trended cost (f) |
| | DD&A: | | | | | | |
| 1 | Successful well costs | 4.46¢ | .60 | 2.68¢ | 4.82¢ | .56 | 2.70¢ |
| 2 | Other production facilities | .89 | .60 | .53 | 1.29 | .56 | .72 |
| 3 | Lease acquisition costs | 2.18 | .60 | 1.31 | 2.54 | .56 | 1.42 |
| 4 | Return on investment @ 13% | 10.13 | .60 | 6.08 | 17.07 | .56 | 9.56 |
| 5 | Return on working capital @ 13% | .65 | | .65 | .76 | | .76 |
| | E&D costs: | | | | | | |
| 6 | Dry holes | 2.12 | | 2.12 | 2.51 | | 2.51 |
| 7 | Other exploratory costs | 1.86 | | 1.86 | 2.54 | | 2.54 |
| 8 | Adjustment | 1.47 | | 1.47 | 1.87 | | 1.87 |
| 9 | Production operating expense | 2.90 | | 2.90 | 3.08 | | 3.08 |
| 10 | Net liquid credit | (4.01) | | (4.01) | (3.95) | | (3.95) |
| 11 | Regulatory expense | .17 | | .17 | .17 | | .17 |
| 12 | Royalty | 4.19 | | 2.89 | 6.46 | | 4.22 |
| 13 | Subtotal | 27.01¢ | | 18.65¢ | 39.16¢ | | 25.60¢ |
| 14 | Conversion to 15.025 | | | 19.02¢ | | | 26.11¢ |
| 15 | Production tax | | | 2.30 | | | 2.30 |
| 16 | Gathering | | | .51 | | | .51 |
| 17 | Total costs @ 13% return | | | 21.83¢ | | | 28.92¢ |

# SOUTHERN LOUISIANA AREA COMPUTATION OF ADJUSTMENT FACTOR FOR ESTIMATED FLOWING GAS (VINTAGE 1) COSTS BY BACK TRENDING
## 1969

| Contract year | Vintage 1 gas deliveries 1969 in Southern Louisiana % | Drilling cost trend Continental U.S. | Weighted drilling cost |
|---|---|---|---|
| (a) | (b) | (c) | (d) |
| 1960 | 10.64 | 3.73 | 39.69 |
| 1959 | 8.99 | 3.29 | 29.58 |
| 1958 | 16.34 | 2.81 | 45.91 |
| 1957 | 7.88 | 2.84 | 22.38 |
| 1956 | 12.81 | 2.58 | 33.05 |
| 1955 | 7.60 | 2.94 | 22.34 |
| 1954 | 2.61 | 2.49 | 6.50 |
| 1953 | 8.36 | 2.55 | 21.32 |
| 1952 | 6.77 | 2.04 | 13.81 |
| 1951 | 7.76 | 2.16 | 16.76 |
| 1950 | 2.56 | 2.02 | 5.17 |
| 1949 | 2.26 | 1.90 | 4.29 |
| 1948 | 1.26 | 2.10 | 2.65 |
| 1947 | 1.33 | 1.74 | 2.31 |
| 1946 | 1.54 | 1.43 | 2.20 |
| 1945 | .01 | 1.21 | .01 |
| 1944 | .63 | 1.15 | .72 |
| 1943 | .11 | 1.16 | .13 |
| 1942 | — | 1.07 | — |
| 1941 | .44 | .94 | .41 |
| 1940 | — | .85 | — |
| 1939 | .10 | .82 | .08 |
| | 100.00 | 2.69 | 269.31 |
| Conversion to 14.73 | | 2.68 | |
| Low cost range factor | | 2.68 = 4.46 | 60.08% |
| High cost range factor | | 2.68 = 4.82 | 55.60% |

## APPENDIX C

Exhibit No. 90
Schedule 2
(V A. 235e)

| Line No. | Company | Revenue at Proposed Settlement Rates Above Effective Rates | | |
|---|---|---|---|---|
| | | Unit | Annual (000) | Unit |
| 1 | Amerada | 23.63¢ | $ 941 | 3.88¢ |
| 2 | Atlantic Richfield | 20.51 | 1,977 | .92 |
| 3 | California Company | 21.79 | 1,857 | .88 |
| 4 | Cities Service Cos. | 22.04 | 2,174 | 2.58 |
| 5 | Forest | 23.66 | 1,194 | 4.05 |
| 6 | General American | 21.73 | 1,212 | 1.06 |
| 7 | Getty | 22.17 | 4,146 | 2.65 |
| 8 | Gulf | 20.61 | 4,972 | 1.09 |
| 9 | Humble | 21.65 | 5,064 | 1.08 |
| 10 | Hunt Interests | 20.79 | ( 130) | ( .32) |
| 11 | Kerr-McGee | 21.19 | 374 | .53 |
| 12 | Marathon | 22.41 | 442 | 2.02 |
| 13 | Mobil | 22.18 | 5,672 | 2.76 |
| 14 | Pan American (Amoco) | 21.94 | 7,112 | 2.44 |
| 15 | Pennzoil | 22.17 | 1,354 | 3.06 |
| 16 | Phillips | 21.41 | 197 | .31 |
| 17 | Placid | 21.97 | ( 25) | ( .06) |
| 18 | Shell | 22.05 | 4,954 | 1.47 |
| 19 | Sun & Sunray DX | 22.07 | 1,565 | 1.37 |
| 20 | Superior | 22.05 | ( 653) | ( .33) |
| 21 | Texaco | 20.98 | 2,202 | .77 |
| 22 | Union Oil of Cal. | 21.51 | 7,129 | 1.79 |
| 23 | Union Texas | 18.34 | 61 | .07 |
| 24 | Other | 21.70 | 16,867 | 1.76 |
| 25 | Total Industry | 21.54¢ | $70,658 | 1.43¢ |

## APPENDIX D

### MUNICIPAL DISTRIBUTION SYSTEMS SUPPORTING UDC SETTLEMENT PROPOSAL

City of Fulton, Kentucky*
City of Hardin, Kentucky
City of Kuttawa, Kentucky
Crockett Public Utility District, Alamo, Tennessee
Town of Friars Point Gas Distribution System, Friars Point, Mississippi
City of Livermore, Kentucky
Village of Flat Rock, Illinois
Maury City, Tennessee*
City of Martin, Tennessee
Henderson, Kentucky*
City of Jonesboro, Illinois*
City of Leitchfield, Kentucky
City of South Fulton, Tennessee*
City of Carrollton, Kentucky
City of Morganfield, Kentucky
City of Holly Grove, Arkansas
City of Clarendon, Arkansas
Town of Olive Branch, Mississippi*
City of Ripley, Tennessee
Town of Henning, Tennessee
First Utility District of Tipton County, Tennessee
City of Sturges, Kentucky
City of Scottsville, Kentucky
City of Providence, Kentucky
Murray Natural Gas System, Murray, Kentucky
City of Friendship, Tennessee
City of Lewisport, Kentucky
City of Linton, Indiana
City of Jasonville, Indiana
City of Clay, Kentucky
Village of Norris City, Illinois
City of Cobden, Illinois
City of Elizabethtown, Kentucky
Bells Public Utility District, Bells, Tennessee
City of Marvell, Arkansas

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* Member of American Public Gas Association

## APPENDIX E



Commonwealth of Kentucky
PUBLIC SERVICE COMMISSION
Frankfort, Kentucky 40601

Federal Power Commission
441 G Street, N.W.
Washington, D.C. 20426

Re: Area Rate Proceedings, *et al.*
(Southern Louisiana Area)
Docket Nos. AR61-2, *et al.*

Area Rate Proceeding
(Southern Louisiana Area)
Docket No. AR69-1

Gentlemen:

On November 6, 1970, a settlement proposal was filed with the Federal Power Commission in the above-referred proceeding by the United Distribution Companies. Various other participants have filed motions with the Commission requesting that the Commission approve the settlement proposal filed by the United Distribution Companies.

The major interstate pipelines which serve the State of Kentucky have as their primary source of supply the area of Southern Louisiana, which is the subject of the above-referred proceeding. Various studies by agencies all over the United States, both public and private and including the Staff of the Commission, have found that there is an acute shortage of natural gas in the United States. In the State of Kentucky, there are communities which desire natural gas service but are unable to receive natural gas service because of the current long-range short-

age of natural gas. In addition thereto, various industries desire to locate facilities within the Commonwealth but they cannot be assured of a long-term supply of natural gas.

In connection with the current gas supply shortage, attached hereto is a resolution which was passed by the Executive Committee of the National Association of Railroad and Regulatory Utility Commissioners on July 23, 1970, relating to the national natural gas supply problem wherein this association requested that the Federal Power Commission take further steps to encourage the exploration of natural gas in the United States.

The Public Service Commission of the Commonwealth of Kentucky has reviewed the settlement proposal, filed by the United Distribution Companies in the above-referred proceeding, and, in our opinion, this settlement proposal may provide the necessary incentive for the producers to seek to develop and explore additional gas reserves in Southern Louisiana and we earnestly urge that the Federal Power Commission approve this settlement proposal at the earliest possible time.

Yours very truly,
Kentucky Public Service
Commission

By: Harold E. Kelley
Chairman

HEK:ra

STATE OF INDIANA
Public Service Commission
Indianapolis 4

December 21, 1970

Federal Power Commission
441 G Street, N.W.
Washington, D.C. 20426

Re: Area Rate Proceedings, *et al.*
(Southern Louisiana Area)
Docket Nos. AR61-2, *et al.*

Area Rate Proceeding
(Southern Louisiana Area)
Docket No. AR69-1

Gentlemen:

The United Distribution Companies on November 6, 1970 filed a settlement proposal with the Federal Power Commission in the above-referred proceeding. Other participants and State Regulatory Commissions have filed motions and letters with the Commission requesting that the Commission approve the settlement proposal filed by the United Distribution Companies.

Because of the current gas supply shortage, the Executive Committee of the National Association of Regulatory Utility Commissioners on July 23, 1970, passed a resolution requesting that the Federal Power Commission take further steps to encourage drilling and exploration for natural gas in the United States.

The current shortage of natural gas is a result of unrealistically low prices at the well head, a condition which has left little or no incentive for discovery and/or development of new gas and which has produced artifically high

demand for gas by under-pricing to consumers in relation to competitive energy sources.

To quote FPC Commissioner Bagge the "crucible of the market should be substituted for continued regulatory anguish and administrative delay." The settlement proposal before the FPC is a step in that direction.

The major interstate pipelines which serve the State of Indiana have as a primary source of supply the area of Southern Louisiana, which is the subject of the above-referred proceeding. Numerous studies and investigations by various groups all over the United States, both public and private and including the Staff of the Commission, have found that there is an acute shortage of natural gas in the United States. In the State of Indiana, there are cities and communities that desire additional natural gas service but are or will be shortly unable to receive such service because of lack of supply. Industries which desire to locate facilities within the State of Indiana cannot be assured of a long-term supply of natural gas.

The Public Service Commission of the State of Indiana has reviewed the settlement proposal, filed by the United Distribution Companies in the above-referred proceeding, and, in our opinion, this settlement proposal will provide increased and necessary incentive for producers to explore for and develop additional gas reserves in Southern Louisiana. We earnestly urge that the Federal Power Commission approve this settlement proposal at the earliest possible time.

Yours very truly,

John L. Ryan, Chairman

JLR/vf

December 16, 1970

Federal Power Commission
441 G Street, N. W.
Washington, D. C. 20426

Re: Area Rate Proceedings, *et al.*
(Southern Louisiana Area)
Docket Nos. AR61-2, *et al.*

Area Rate Proceeding
(Southern Louisiana Area)
Docket No. AR69-1

Gentlemen:

On November 6, 1970, a settlement proposal was filed with the Federal Power Commission in the above-referred proceeding by the United Distribution Companies. Various other participants have filed motions with the Commission requesting that the Commission approve the settlement proposal filed by the United Distribution Companies.

In connection with the current gas supply shortage, attached hereto is a resolution which was passed by the Executive Committee of the National Association of Railroad and Regulatory Utility Commissioners on July 23, 1970, relating to the national natural gas supply problem wherein this association requested that the Federal Power Commission take further steps to encourage the exploration of natural gas in the United States.

The major interstate pipelines which serve the State of Mississippi have as their primary source of supply the area of Southern Louisiana, which is the subject of the above-referred proceeding. Various studies by agencies all over the United States, both public and private and in-

cluding the Staff of the Commission, have found that there is an acute shortage of natural gas in the United States. In the State of Mississippi, there are communities which desire natural gas service but are unable to receive natural gas service because of the current long-run shortage of natural gas. In addition thereto, various industries desire to locate facilities within the State but they cannot be assured of a long-term supply of natural gas.

The Public Service Commission of the State of Mississippi has received the settlement proposal, filed by the United Distribution Companies in the above-referred proceeding, and, in our opinion, this settlement proposal may provide the necessary incentive for the producers to seek to develop and explore additional gas reserves in Southern Louisiana and we earnestly urge that the Federal Power Commission approve this settlement proposal at the earliest possible time.

Yours very truly,

W. E. "Bucky" Moore, Chairman
Mississippi Public Service
Commission

WEM: gd

## APPENDIX F



OFFSHORE SOUTH LOUISIANA: OFFSHORE LEASE SALES SINCE ISSUANCE OF OPINION 598
SUCCESSFUL BIDDERS RANKED BY AMOUNT BID

11/4/71 LEASE SALE

| Company | (000 Dollars) |
|---|---|
| 1. Atlantic Richfield Co. | $31,718 |
| 2. Continental, Getty, Cities Service (CGC) | 29,520 |
| 3. Chevron Oil Co. | 10,914 |
| 4. Exxon Corp. | 8,672 |
| 5. Chevron & Mobil | 6,262 |
| 6. Oil & Gas Futures | 5,288 |
| 7. Slam—Signal Oil, Louisiana Land & Exploration Co., Amerada Hess & Marathon Oil Co. | 2,200 |
| 8. Texaco Inc. | 1,730 |
| Total | $96,304 |

## OFFSHORE SOUTH LOUISIANA: OFFSHORE LEASE SALES SINCE ISSUANCE OF OPINION 598 SUCCESSFUL BIDDERS RANKED BY AMOUNT BID

### 9/12/72 LEASE SALE

| | Company | (000 Dollars) |
|---|---|---|
| 1. | Gulf Group[a] | $147,421 |
| 2. | Exxon Corp. | 82,094 |
| 3. | Gulf, Mobil, Chevron | 62,655 |
| 4. | Texaco Inc. | 52,185 |
| 5. | Gulf & Amoco | 41,400 |
| 6. | Gulf & Mobil | 37,042 |
| 7. | Amoco, Texas Eastern | 34,292 |
| 8. | Amoco, Union Oil, Texas Eastern | 29,920 |
| 9. | Skelly Oil Co. | 19,609 |
| 10. | Slam Group[b] | 16,100 |
| 11. | Pogo, Plato, Mesa, Burmah, Occidental | 15,146 |
| 12. | Tenneco-Texaco | 11,018 |
| 13. | Chevron Oil Co. | 10,914 |
| 14. | Shell Group[c] | 6,230 |
| 15. | Signal Oil Co. | 5,150 |
| 16. | Oil & Gas Futures | 4,411 |
| 17. | Sun Oil Co. | 3,829 |
| 18. | Mobil Oil Corp. | 3,636 |
| 19. | Continental, Texaco, Cities (CTC) | 3,210 |
| 20. | Continental, Getty, Cities (CGC) | 2,748 |
| 21. | Gulf & Chevron | 1,127 |
| | Total | $585,454 |

[a] *Gulf Group*—Gulf Oil, Mobil, Pennzoil Offshore Gas Operators (Pogo), Pennzoil L & T Offshore Inc. (Plato).

[b] *Slam Group*—Signal, Louisiana Land & Exploration, Amerada Hess, and Marathon Oil Co.

[c] *Shell Group*—Shell, Florida Gas Exploration, Sabine Exploration Corp., Drillmax, Inc., Kirby Petroleum Co., The Royal Gorge Co., American Independent Oil Co.

# OFFSHORE SOUTH LOUISIANA: OFFSHORE LEASE SALES SINCE ISSUANCE OF OPINION 598 SUCCESSFUL BIDDERS RANKED BY AMOUNT BID

## 12/19/72 LEASE SALE

| | Company | (000 Dollars) |
|---|---|---|
| 1. | Shell, Transco | $221,409 |
| 2. | Columbia Gas Development, Energy Ventures, Inc., Forest Oil Co. | 200,038 |
| 3. | Transocean Oil Group[a] | 178,170 |
| 4. | CAGC[b] | 135,078 |
| 5. | Sun Oil Co. | 117,980 |
| 6. | Tenneco-Texaco | 110,296 |
| 7. | Burmah-Mesa | 101,263 |
| 8. | Marathon, LL&E, Texas Eastern | 76,015 |
| 9. | Mobil, Plato, Pogo, Burmah, Mesa | 61,482 |
| 10. | Amoco, Northwest Life, CNG Production | 53,024 |
| 11. | Chevron Group[c] & Pelto Oil Co. | 44,355 |
| 12. | Chevron Group[c] | 41,408 |
| 13. | Mobil, Chevron, Pogo, Plato | 34,609 |
| 14. | Louisiana Land & Exploration (LL&E) | 31,016 |
| 15. | Continental Oil Co. | 25,347 |
| 16. | Sonat Group[d] | 25,139 |
| 17. | Continental, Getty, Cities Service (CGC) | 23,733 |
| 18. | Phillips, American Petrofina | 19,415 |
| 19. | Chevron Oil Co. | 18,649 |
| 20. | Kerr-McGee, Cabot, Felmont, Case-Pomeroy | 13,160 |
| 21. | Mobil, Chevron, Pogo, Plato, Texas Production | 12,878 |
| 22. | Continental, Atlantic, Cities Service (CAC) | 12,853 |
| 23. | Atlantic Richfield | 12,773 |
| 24. | Gulf Oil Corp. | 11,210 |

| Company | (000 Dollars) |
|---|---|
| 25. Phillips, Skelly, Allied Chemical, American Petrofina | 10,256 |
| 26. Phillips, Skelly, Texas Gulf, Allied Chemical, Texas Production | 10,228 |
| 27. Signal, LL & E, Marathon, Texas Eastern | 9,510 |
| 28. Shell Oil Co. | 8,333 |
| 29. Signal, LL & E, Texas Eastern | 7,005 |
| 30. Phillips, Skelly, Texas Gulf | 6,457 |
| Total Number of Bidders—40 Total | $1,665,520 |

[a] *Transocean Oil Group*—Transocean Oil Co., Ashland Oil Co., Hamilton Brothers, Highland Resources, Hunt Oil Co., Kewanee Oil Co., Placid Oil Co.

[b] *CAGC*—Continental Oil Co., Atlantic Richfield, Getty Oil Co., Cities Service Oil Co.

[c] *Chevron Group*—Chevron Oil, Superior Oil Co., Canadian Superior, Murphy Oil, Odeco, Ocean Oil & Gas, Aztec Oil, General American Oil Co.

[d] *Sonat Group*—Sonat Exploration Co., Southland Royalty Co., The Offshore Co., Midwest Oil Corp., Newmont Oil Co., Samedan Offshore Corp., Champlin Petroleum Co.

# OFFSHORE SOUTH LOUISIANA: OFFSHORE LEASE SALES SINCE ISSUANCE OF OPINION 598 SUCCESSFUL BIDDERS RANKED BY AMOUNT BID

## 6/19/73 LEASE SALE

| Company | (000 Dollars) |
|---|---|
| 1. Pogo & Exxon | $24,460 |
| 2. Pogo, Mobil, Cities Service Oil, Texas Production | 24,405 |
| 3. Amoco, Union Oil, Texas Eastern | 6,116 |
| 4. Clark Oil Co. | 3,522 |
| 5. Pogo, Mobil, Mesa, Texas Production | 1,515 |
| Total | $60,018 |

## OFFSHORE SOUTH LOUISIANA: OFFSHORE LEASE SALES SINCE ISSUANCE OF OPINION 598 SUCCESSFUL BIDDERS RANKED BY AMOUNT BID

| Company | Lease Sales 11/4/71 | 9/12/72 | 12/19/72 | 6/19/73 | Total |
|---|---|---|---|---|---|
| | | | (000 Dollars) | | |
| 1. Shell, Transco. | — | — | $ 221,409 | — | $ 221,4 |
| 2. Columbia Gas Devel. Energy Ventures, Forest Oil | — | — | 200,038 | — | 200,0 |
| 3. Transocean Oil Group[a] | — | — | 178,170 | — | 178,1 |
| 4. Gulf Group[b] | — | $147,421 | — | — | 147,4 |
| 5. CAGC[c] | — | — | 135,078 | — | 135,0 |
| 6. Sun Oil Co. | — | 3,829 | 117,980 | — | 121,8 |
| 7. Tenneco-Texaco Inc. | — | 11,018 | 110,296 | — | 121,3 |
| 8. Burmah, Mesa | — | — | 101,263 | — | 101,2 |
| 9. Exxon Corp. | $ 8,673 | 82,094 | — | — | 90,7 |
| 10. Marathon, LL&E, Texas Eastern | — | — | 76,015 | — | 76,0 |
| 11. Gulf, Mobil, Chevron | — | 62,655 | — | — | 62,6 |
| 12. Mobil, Pogo, Plato, Burmah, Mesa | — | — | 61,482 | — | 61,4 |
| 13. Continental, Getty, Cities (CGC) | 29,520 | 2,748 | 23,733 | — | 56,0 |
| 14. Texaco Inc. | 1,730 | 52,185 | — | — | 53,9 |
| 15. Amoco, Northwest Life, CNG Prod'n. | — | — | 53,024 | — | 53,0 |
| 16. Atlantic Richfield | 31,718 | — | 12,773 | — | 44,4 |
| 17. Chevron Group,[d] Pelto Oil | — | — | 44,355 | — | 44,3 |
| 18. Chevron Group[d] | — | — | 41,408 | — | 41,4 |
| 19. Gulf & Amoco | — | 41,400 | — | — | 41,4 |
| 20. Gulf & Mobil | — | 37,042 | — | — | 37,0 |
| 21. Amoco, Union Oil, Texas Eastern | — | 29,920 | — | $ 6,116 | 36,0 |
| 22. Chevron Oil Co. | 10,914 | 6,231 | 18,649 | — | 35,7 |
| 23. Mobil, Chevron, Pogo, Plato | — | — | 34,609 | — | 34,6 |
| 24. Amoco, Texas Eastern | — | 34,292 | — | — | 34,2 |
| 25. LL&E | — | — | 31,016 | — | 31,0 |
| 26. Continental Oil Co. | — | — | 25,347 | — | 25,3 |
| 27. Sonat Group[e] | — | — | 25,139 | — | 25,1 |
| 28. Pogo, Exxon | — | — | — | 24,460 | 24,4 |
| 29. Pogo, Mobil, Cities Service, Texas Prod'n. | — | — | — | 24,405 | 24,4 |
| 30. Skelly Oil Co. | — | 19,609 | — | — | 19,6 |
| Total Dollars in High Bids | $96,304 | $585,454 | $1,665,520 | $60,018 | $2,407,2 |
| Total Leases Sold | 10 | 60 | 116 | 5 | 191 |
| Total Number of Different High Bidders Including Groups | 8 | 21 | 40 | 5 | 60 |

[a] *Transocean Oil Group*—Transocean Oil Co., Ashland Oil Co., Hamilton Brothers, Highland Resources, Hunt Oil Co., Kewanee Oil Co., Placid Oil Co.
[b] *Gulf Group*—Gulf Oil, Mobil, Pennzoil Offshore Gas Operators (Pogo), Pennzoil L & T Offshore Inc. (Plato).
[c] *CAGC*—Continental Oil Co., Atlantic Richfield, Getty Oil Co., Cities Service Oil Co.
[d] *Chevron Group*—Chevron Oil, Superior Oil Co., Canadian Superior, Murphy Oil, Odeco, Ocean Oil & Gas, Aztec Oil, General American Oil Co.
[e] *Sonat Group*—Sonat Exploration Co., Southland Royalty Co., The Offshore Co., Midwest Oil Corp., Newmont Oil Co., Samedan Offshore Corp., Champlin Petroleum Co.

Source: Lease Sale Data, Offshore Louisiana, Bureau of Land Management, Department of the Interior. (Also used the information included in the appropriate Oil & Gas Journal articles concerning each sale.) Rejected bids are excluded.